Monday, October 31, 2022

Company Report

China Merchants Securities (HK) Co., Ltd.
Hong Kong Equity Research

Shanghai Pharma (2607 HK)

3Q22 revenue in recovery, but profit under pressure

- **9M22 revenue/core net profit grew 8%/4% yoy, reflecting 3Q22 revenue/core net profit grew 13%/2% yoy, in line with CMS est.**
- **CanSino SPH now has up to 200mn doses manufacturing capacity for the new CanSino's inhaled COVID vaccine**
- **Current stock valuation remains attractive (7x FY23E PER). Maintain BUY with TP at HKD18.5**

3Q22 rev in recovery mode, but profits still under pressure

Manufacturing sales grew 13% yoy to ~RMB6.7bn in 3Q22, reflecting a recovery from outbreak in 2Q22 and steady sales of 60 key products. **Distribution** rev grew 13% yoy to ~RMB56bn in 3Q22 thanks to COVID recovery and strong growth in non-medicine healthcare business (grew ~50% yoy to over RMB25bn in 9M22). **Retail** rev grew 15% yoy to ~RMB2.1bn. Co. believes its growing one-stop innovative platform (from clinical-stage cooperation to import and export services to nationwide distribution) should help weather the ongoing VBP policies. 3Q22 overall GPM down 0.9ppt yoy to 11.9% mainly due to adverse VBP impacts (distribution GPM down ~1.1ppt to 5.2%). We reckon this trend to persist given ongoing VBP policies. 3Q22 OCF remained weak but turned positive to RMB397mn (-47% yoy) after a cash outflow in 1H22 (negative RMB556mn). This is because of the sustained A/R pressures (from 93days to 117days) as a result of slower collection of A/R from hospitals during pandemic.

Well prepared to manufacture new COVID vaccine

The new CanSino SPH manufacturing facility in Shanghai has annual manufacturing capacity up to 200mn doses. CanSino's inhaled COVID vaccine in Sep has been approved for EUA as a first inhaled booster. We think Co. is well positioned to grow its presence in the heterologous COVID booster market. Meanwhile, we believe it helps strengthen its vaccine franchise to obtain more new import general agencies for novel vaccine products.

Maintain BUY with TP unchanged at HKD18.5

We maintain financial forecast for FY22E/23E unchanged. SOTP-based TP also remained at HKD18.5. We believed its healthy B/S and its capital allocation capabilities should drive re-rate opportunities. **Investment risks:** VBP, R&D risk, COVID-19, etc.

RMB mn	2019	2020	2021	2022E	2023E
Revenue	186,566	191,909	215,824	228,665	249,982
Growth	17%	3%	12%	6%	9%
Adj. net profit	3,449	3,792	3,875	4,074	4,586
Growth	13%	10%	2%	5%	13%
EPS (RMB)	1.22	1.34	1.37	1.19	1.24
DPS (RMB)	0.44	0.48	0.42	0.39	0.43
P/E (x)	7.7	7.1	6.4	7.7	7.4
P/B (x)	0.6	0.6	0.5	0.5	0.5
ROE	9.8%	9.9%	10.4%	7.1%	7.5%

Sources: Company data, CMS (HK) estimates, our adj. net profit has been adjusted for one-off income/expenses and SBC, price as of Oct 31, 2022

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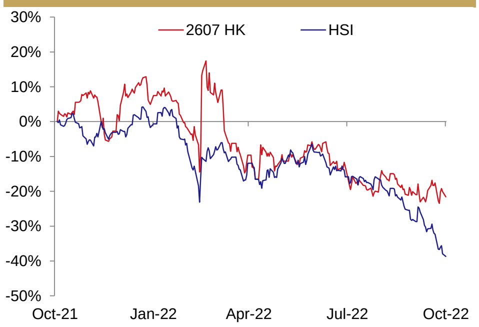
WHAT'S NEW

3Q22 earnings update

BUY

Previous	BUY
Price (Oct 31, 2022)	HKD10.6
12-month Target Price (Potential up/downside)	HKD18.5 (+74%)
Previous	HKD18.5

Price Performance



Source: Bloomberg

%	1m	6m	12m
2607 HK	(0.7)	(13.2)	(16.8)
HSI	(14.0)	(30.4)	(41.5)

Sector: Pharmaceutical & Healthcare	
Hang Seng Index (Oct 31, 2022)	14,687
HSCEI (Oct 31, 2022)	4,939
Key Data	
52-week range (HKD)	10.1-17.8
Market cap (HKD mn)	62,295
Avg. daily traded value (HKD mn)	29.1
BVPS (HKD)	23.6
Shareholding Structure	
Shanghai SASAC	35.5%
Yunnan Baiyao	18.0%
BlackRock	1.8%
Free float	44.7%

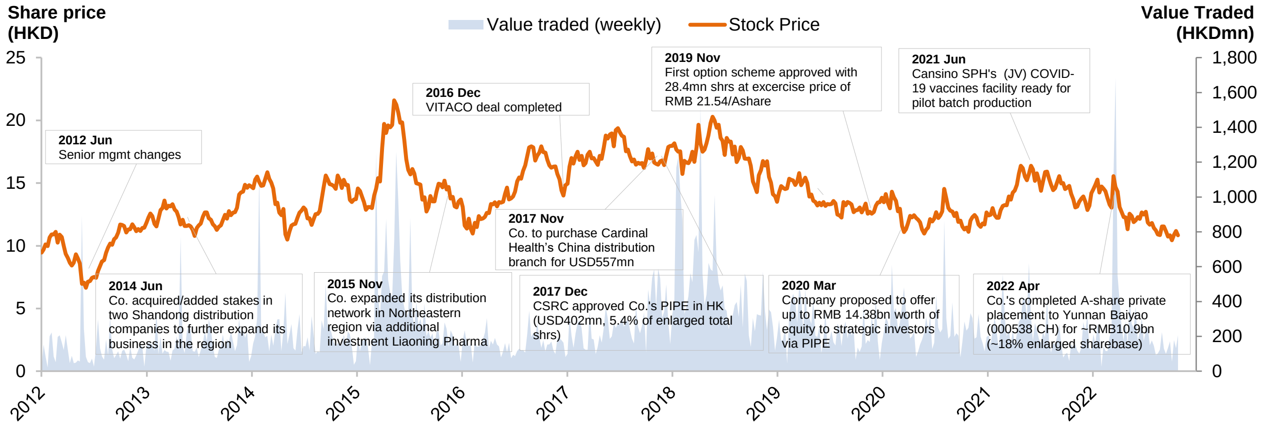
Sources: Company, Bloomberg

Related Research

1. Shanghai Pharma (2607 HK) – A weak 2Q22 was expected (BUY) (Aug 30, 2022)
2. Shanghai Pharma (2607 HK) – Challenging 2Q22E due to COVID lockdown (BUY) (May 19, 2022)
3. Shanghai Pharma (2607 HK) – GPO weighs on 3Q21 results (BUY) (Nov 3, 2021)
4. Shanghai Pharma (2607 HK) – Solid 1Q21 results to continue to support re-rate (BUY) (May 5, 2021)

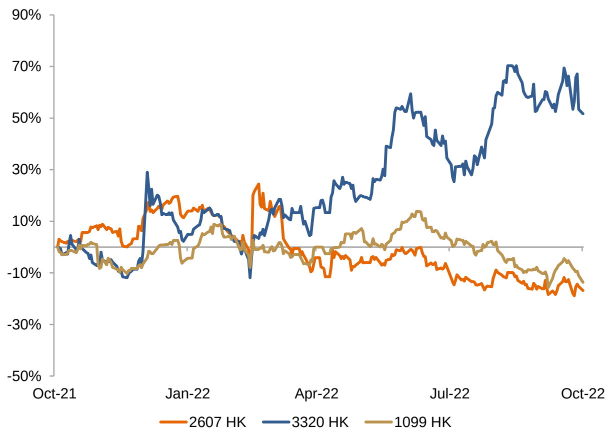
Focus charts

Figure 1: Stock performance and events of SH Pharm



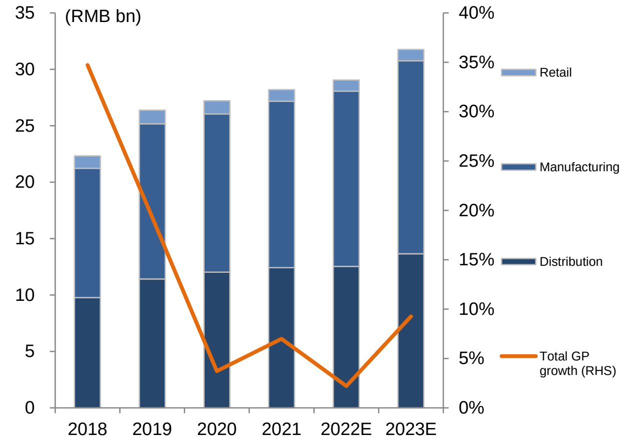
Sources: Bloomberg, CMS (HK)

Figure 2: 12m performance of SH Pharm (2607 HK), CR Pharm (3320 HK) and Sinopharm (1099 HK)



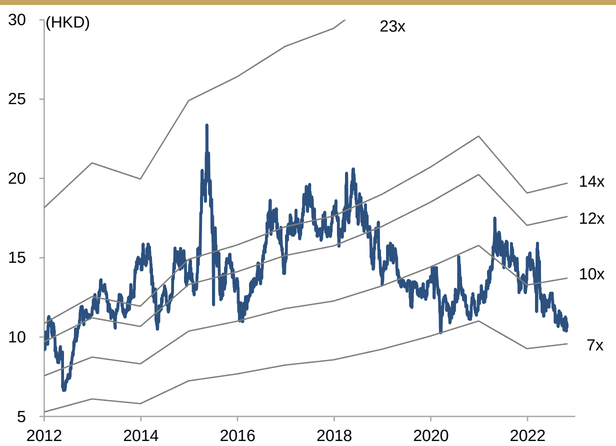
Source: Bloomberg

Figure 3: Gross profit breakdown by segments



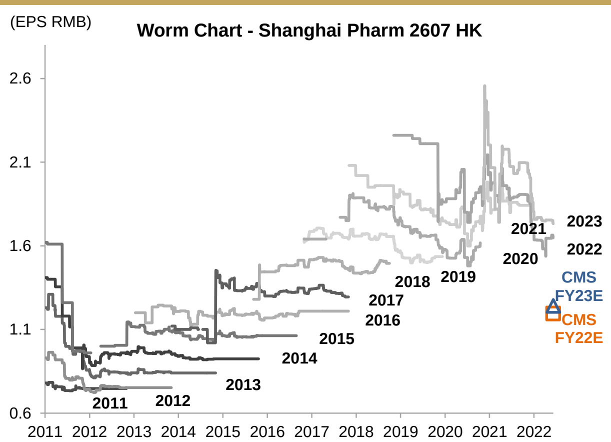
Source: CMS (HK) estimates

Figure 4: PER band



Sources: Bloomberg, CMS (HK) estimates

Figure 5: Adj. EPS consensus worm chart



Sources: Bloomberg, CMS (HK) estimates

Valuation

Figure 6: SOTP Valuation

(RMB mn)	
Gross profit	
Pharma manufacturing	17,420
Pharma distribution & retail	14,651
Total SG&A	
Pharma manufacturing	(14,767)
Pharma distribution & retail	(9,051)
NOPAT	
Pharma manufacturing	2,057
Pharma distribution & retail	4,340
Valuation	
Pharma manufacturing (13x NOPAT)	26,735
Pharma distribution & retail (9x NOPAT)	39,063
Less: net debt	7,012
Less: minorities valuation	(10,756)
Equity value	62,053
# of shares (mn)	3,696
TP (HKD)	**18.5**

Source: CMS (HK) estimates

Financial Summary

Balance Sheet

RMB mn	2019	2020	2021	2022E	2023E
Cash and cash equivalents	15,716	19,576	20,138	36,684	38,784
ST investments	4,624	2,720	2,253	2,253	2,253
Inventories	24,877	24,088	27,104	30,033	32,836
Other current assets	52,874	61,178	67,000	71,418	77,517
Total current assets	**98,092**	**107,563**	**116,494**	**140,388**	**151,390**
Property, plant & equipment	11,901	12,228	13,398	14,192	14,915
Other assets	10,411	10,449	13,833	13,833	13,833
Intangible assets	16,617	18,945	19,710	18,605	17,570
Total non-current asset	**38,929**	**41,623**	**46,941**	**46,630**	**46,318**
Total assets	**137,026**	**149,186**	**163,436**	**187,018**	**197,708**
Accounts payable	47,936	49,935	55,058	60,067	65,672
ST bank loans	23,764	20,139	22,515	22,515	22,515
Income taxes payable	717	1,478	1,693	1,693	1,693
Other current liabilities	2,191	16,581	12,559	12,559	12,559
Total current liabilities	**74,608**	**88,133**	**91,824**	**96,833**	**102,438**
Long term debt	9,134	1,184	7,158	7,158	7,158
Deferred taxes	810	832	999	999	999
Other liabilities	3,089	4,295	4,388	4,388	4,388
Total non-current liabilities	**13,033**	**6,312**	**12,545**	**12,545**	**12,545**
Total liabilities	**87,640**	**94,445**	**104,369**	**109,378**	**114,983**
Minority interest	7,727	9,386	9,707	10,756	11,933
Common equity	41,659	45,355	49,359	66,884	70,792
Total equity	**49,386**	**54,741**	**59,066**	**77,640**	**82,725**

Cash Flow Statement

RMB mn	2019	2020	2021	2022E	2023E
PBT	6,262	7,175	8,144	7,497	8,404
Depreciation and amortization	2,042	2,119	2,119	2,311	2,312
Operating profit before chg. in WC	9,813	13,088	13,531	11,266	11,909
Funds from other operating activities	(2,388)	(1,780)	(3,564)	(2,338)	(3,297)
Cash from operating activities	**4,367**	**8,257**	**6,580**	**5,460**	**4,941**
Capital expenditure	(2,128)	(3,010)	(4,119)	(2,000)	(2,000)
Purchase intangible assets	(625)	-	-	-	-
Net assets from acquisition	(2,452)	(2,046)	(1,039)	-	-
Interest received	234	288	388	322	587
Others	621	3,062	(1,246)	-	-
Cash from investing activities	**(4,350)**	**(1,706)**	**(6,016)**	**(1,678)**	**(1,413)**
Bank borrowings	1,706	1,689	4,332	-	-
Common dividends (cash)	(1,595)	(1,251)	(1,364)	(1,194)	(1,428)
Net proceeds of issuance of equity	-	-	-	13,958	-
Others	-	-	-	-	-
Cash from financing activities	**(907)**	**(2,673)**	**47**	**12,764**	**(1,428)**
Net Cash - beginning balance	**16,605**	**15,716**	**19,576**	**20,138**	**36,684**
Net change in cash	(890)	3,878	611	16,547	2,100
Net Cash - ending balance	**15,716**	**19,576**	**20,138**	**36,684**	**38,784**

Profit & Loss Statement

RMB mn	2019	2020	2021	2022E	2023E
Revenue	**186,566**	**191,909**	**215,824**	**228,665**	**249,982**
Cost of sales	(160,685)	(165,067)	(187,947)	(199,313)	(217,910)
Gross profit	25,881	26,842	27,877	29,352	32,071
SG&A expenses	(17,561)	(17,597)	(18,461)	(19,551)	(21,498)
Operating profit	**6,970**	**7,589**	**7,428**	**7,693**	**8,254**
Interest income	234	288	388	322	587
Interest expense	(1,423)	(1,412)	(1,518)	(1,780)	(1,780)
PBT	6,262	7,175	8,144	7,497	8,404
Income tax	(1,432)	(1,570)	(1,869)	(1,687)	(1,891)
Minority interest	(750)	(1,104)	(1,148)	(1,050)	(1,177)
Net profit	**4,081**	**4,501**	**5,127**	**4,760**	**5,336**
Adj. net profit	**3,449**	**3,792**	**3,875**	**4,074**	**4,586**
EPS - diluted (RMB)	**1.22**	**1.34**	**1.37**	**1.19**	**1.24**
DPS (RMB)	0.44	0.48	0.42	0.39	0.43

Financial Ratio

	2019	2020	2021	2022E	2023E
Growth (yoy)					
Revenue	17.3%	2.9%	12.5%	5.9%	9.3%
Gross profit	19.3%	3.7%	3.9%	5.3%	9.3%
Operating profit	29.0%	8.9%	-2.1%	3.6%	7.3%
Adj. net profit	12.7%	9.9%	2.2%	5.2%	12.6%
Margin					
Gross margin	13.9%	14.0%	12.9%	12.8%	12.8%
EBITDA margin	4.8%	5.1%	4.4%	4.4%	4.2%
Operating margin	3.7%	4.0%	3.4%	3.4%	3.3%
Adj. net profit margin	1.8%	2.0%	1.8%	1.8%	1.8%
Efficiency					
Inventory days	57	53	53	55	55
Trade receivable days	102	104	102	103	103
Account payable days	109	110	107	110	110
Financial ratios					
Current ratio (x)	1.3	1.2	1.3	1.4	1.5
Quick ratio (x)	1.0	0.9	0.9	1.1	1.1
ROA	3.0%	3.0%	3.1%	2.5%	2.7%
ROE	9.8%	9.9%	10.4%	7.1%	7.5%
Net gearing	34.8%	3.2%	16.1%	-9.0%	-11.0%

Sources: Company data, CMS (HK) estimates

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
HOLD	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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